No. 72-312

In the Supreme Court of the United States

OCTOBER TERM, 1973

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
PETITIONER

v.

DAVID WARE, ET AL.

ON WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA FOR THE FIRST APPELLATE DISTRICT

BRIEF OF THE UNITED STATES AS AMICUS CURIAE

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INDEX

CITATIONS

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QUESTION PRESENTED

The United States will discuss the following question:

Whether, where an employee of a member firm of the New York Stock Exchange has entered into an agreement to arbitrate any dispute relating to his employment, as required by a rule of the Exchange, the Securities Exchange Act of 1934 preempts the application to such an employment dispute of a California statute providing that actions for wages can be maintained without regard to arbitration agreements.

THE INTEREST OF THE UNITED STATES

At the Court's invitation, the United States filed a memorandum *amicus curiae* at the petition stage. The government has an interest in the issues raised by the parties, which concern the effect of the Securities Exchange Act of 1934 on the applicability of state law to rules of a stock exchange registered with and regulated by the Securities and Exchange Commission.

STATEMENT

Petitioner ("Merrill Lynch"), a securities broker-dealer registered with the Securities and Exchange Commission, is a member of several stock exchanges located in different states, including the New York Stock Exchange, located in New York. It has a profit-sharing plan for its employees containing a provision that any employee who voluntarily terminates his employment with Merrill Lynch forfeits his vested interest in the plan if he subsequently is employed by a competitor of Merrill Lynch or establishes a competitive business (A. 38).[1]

Respondent David Ware, a California resident and a former registered representative of Merrill Lynch employed at one of its California offices, has been denied distribution of his earned profit-sharing credits under this forfeiture provision. Mr. Ware brought a class action in a state court in California, alleging that the forfeiture provision was invalid under California Business and Professions Code Section 16600 (Pet.

[1] "A." refers to the printed appendix. "Pet. Br.", or "Res. Br." refers to petitioner's or respondents' briefs. "Pet. A" refers to Appendix A of petitioner's brief.

Br. 4), which voids any contract to the extent that an individual is restrained from engaging in a lawful occupation.

Merrill Lynch petitioned for an order compelling arbitration of the dispute on the basis of a written agreement between it and Mr. Ware in which he agreed that any dispute arising out of his employment would be settled by arbitration in accordance with the rules of the Exchange (A. 53, 55–56; cf. Pet. A8). Rule 347(b) of the Exchange provides that any controversy between a registered representative and a member of the Exchange arising out of the representative's employment by a member thereof shall be settled by arbitration (Pet. A9).

The trial court denied the petition to compel arbitration, and the California Court of Appeal affirmed on the basis of Section 229 of the California Ann. Labor Code (Pet. Br. 5), which provides that actions for wages can be maintained without regard to arbitration agreements.

DISCUSSION

1. A federal law will not ordinarily be found to supersede or preempt application of a state law unless there is "such actual conflict between the two schemes of regulation that both cannot stand in the same area," or there is "evidence of a congressional design to preempt the field." *Florida Lime & Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 141. A finding of preemption may be dictated by the nature of the regulated subject, *id.* at 142, by the existence of a pervasive and comprehensive scheme of federal

regulation that "requires a uniform and exclusive system of federal regulation" to fulfill the federal statutory purposes, *City of Burbank* v. *Lockheed Air Terminal, Inc.*, 411 U.S. 624, 639, or by the presence of such a conflict with the federal statute or the federal regulatory scheme that application of the state law would frustrate the purpose of the federal law. *Colorado Anti-Discrimination Comm'n* v. *Continental Air Lines, Inc.*, 372 U.S. 714, 724; *Rice* v. *Chicago Board of Trade*, 331 U.S. 247, 253–255.

Under these principles, we submit that in the circumstances of this case, Section 229 of the California Ann. Labor Code has not been preempted by the Securities Exchange Act of 1934.

2. Prior to enactment of the Securities Exchange Act of 1934, the power of regulation of the nation's securities exchanges rested primarily with the exchanges themselves, subject to such limited and largely ineffectual state or local laws as might have borne upon their operations. The legislative history of that Act, engendered by the stock market crash of 1929, reveals that Congress concluded that the prevailing degree of reliance on self-regulation of the activities of exchanges and their members was inadequate, that their autonomy should be limited, and that a measure of federal regulation was required.[2] But Congress did not give the newly-created Securities and Exchange Commission total and exclusive power over

[2] See generally *Stock Exchange Practices*, Report of the Senate Committee on Banking and Currency, S. Rep. No. 1455, 73d Cong., 2d Sess.; S. Rep. No. 792, 73d Cong., 2d Sess.; H. Rep. No. 1383, 73d Cong., 2d Sess.

all exchange functions. Rather, the Act provided for substantial federal regulation of exchange activities relating to investor protection, fair dealing in securities, and fair administration of exchanges; in other respects it continued the application of state law to the exchanges and, subject to the constraints of federal and state law, permitted exchanges to continue to regulate themselves to a substantial extent.

In particular, the Act drew a significant distinction between the scope of authority left to the exchanges free of federal regulation with respect to "administration of their ordinary affairs," and the restricted authority permitted to the exchanges with respect to maters subject to Commission supervision that more directly affect the investing public. Thus, the Senate Committee's report stressed that under the Act "the initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves." But "where * * * [exchanges] fail adequately to provide protection to investors * * * the Commission is authorized to step in and compel them to do so." S. Rep. No. 792, 73d Cong., 2d Sess. 13.[3]

The Act contains a general standard that, to obtain registration, an exchange must have rules that are "just and adequate to insure fair dealing and to pro-

[3] The intention was therefore one of "letting the exchanges take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used." Douglas, *Democracy and Finance*, 88 (Allen ed., 1940).

tect investors * * *." 15 U.S.C. 78f(d). In particular, a registered exchange is obliged to have rules that provide for disciplining its members for "conduct or proceeding inconsistent with just and equitable principles of trade" and that declare any violation of the Act or the Commission's rules or regulations thereunder to be such conduct. 15 U.S.C. 78f(b).

Otherwise, the Act left exchanges a zone of freedom and discretion as to their rules. Thus, exchanges are generally authorized under Section 6(c), 15 U.S.C. 78f(c), to promulgate and enforce rules "not inconsistent with * * * [the Act] and the applicable laws of the State in which * * * [the exchange] is located."[4] Moreover, Section 19(b) of the Act, 15 U.S.C. 78s(b), which authorizes the Commission "to alter or supplement" exchange rules on twelve specified subjects and "similar matters" by rule or regulation or by order, may be regarded as implicitly authorizing exchanges to adopt rules on the enumerated matters, none of which is involved here.[5]

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[4] Before an exchange may be registered, it must agree to furnish "copies of any amendments to the rules of the exchange forthwith upon their adoption," Section 6(a)(4), 15 U.S.C. 78f(a)(4). Commission Rule 17a-8, 17 C.F.R. 240.17a-8, requires that each exchange submit to the Commission the text of "any proposed amendment or repeal of, or any addition to, its rules," including its constitution, articles of incorporation, by-laws, and stated policies, at least three weeks before any action is taken on the proposal.

[5] This list encompasses—

"Such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate

The Commission is authorized to act under Section 19(b) when it finds a change in an exchange's rules to be

> necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange * * *.

Under Section 19(b), therefore, as the House Committee Report on the bill stated,

> [t]he Commission is empowered, if the rules of the exchange *in any important matter* are not appropriate for the protection of investors

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forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchanges, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters."

The Commission has recognized:

"It is clear from this language [of Section 19(b)] that Congress did not intend to empower this Commission to alter or supplement *all* rules of a national securities exchange. At the same time it is plain that the language 'such matters as' and 'similar matters' calls for a broad construction of the section." *In the Matter of the Rules of the New York Stock Exchange*, 10 S.E.C. 270, 294.

> or appropriate to insure fair dealing, to order such changes in the rules after due notice and hearings as it may deem necessary. [H. Rep. No. 1383, 73d Cong., 2d Sess. 15. (emphasis supplied).]

In addition, the Commission has broad rulemaking authority under the Act to deal directly with certain other matters.[6] Accordingly, with respect to "any important matter," as the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs has recently observed,[7]

> [t]he Commission's powers of direct rule making * * * and its "reserved" authority in section 19 are complementary. Taken together they provide the Commission with pervasive regulatory authority over and responsibility for the operations of exchange markets and the conduct of persons who use those markets.

Finally, although criminal sanctions were provided for violations of the Act or Commission rules or regulations, 15 U.S.C. 78ff(a), there are no such federal sanctions for violation of rules of an exchange.[8]

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[6] *See, e.g.*, the Commission's authority to regulate exchange transactions concerning options under § 9(b) of the Act, 15 U.S.C. 78i(b); members trading for their own accounts, § 11(a), 15 U.S.C. 78k(a); hypothecating of customers' securities, §8, 15 U.S.C. 78h.

[7] *Security Industry Study*, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, S. Doc. No. 93-13, 93d Cong., 1st Sess. 143.

[8] To the contrary, the Act merely provides that, to obtain registration, an exchange must file with the Commission an agreement "to enforce so far as is within its powers compliance by its members" with the Act and the Commission's rules and regulations thereunder. 15 U.S.C. 78f(a)(1).

3. Petitioner contends that application of Section 229 of the California Ann. Labor Code would lead to "disparate" results and would conflict with an exchange rule—Rule 347(b)—adopted under Section 6 of the Act, thus creating a conflict with the Congressional objective of self-regulation under the Act (Pet. Br. 8, 13). As the petitioner recognizes (Pet. Br. 22), however, neither the Securities Exchange Act nor any rule or regulation adopted thereunder by the Commission purports to establish arbitration as the generally-favored procedure for resolving all disputes between exchange members and their employees.[9] In other words, there is no basis for suggesting that Rule 347(b) was required to implement the literal language of the Act or any Commission rule.

Moreover, an exchange rule like Rule 347(b), which, if applicable, would merely require the respondent to arbitrate his dispute with his employer, deals with one of the "ordinary affairs" of the exchange that, as we have shown (*supra*, p. 5), Congress did not intend were to concern the Commission; the relationship of such a rule to investor protection, fair dealing or fair exchange administration—which are the standards under Section 19(b)—is extremely attenuated and peripheral, if it exists at all. Accordingly, the Commission would have no jurisdiction

[9] Petitioner's reliance (Pet. Br. 17) upon a passing reference to arbitration in *Silver v. New York Stock Exchange*, 373 U.S. 341, 354, n. 9, is misplaced, for there the Court was dealing, in another context, with exchange rules concerning relationships between exchange members and nonmember firms dealing in over-the-counter securities. See *infra*, pp. 11–12 n. 13.

under Section 19(b) to modify or review the operation of Rule 347(b).[10]

Neither the Act nor any Commission rule or regulation purports to displace state law or to require nation-wide uniformity as to an exchange's ordinary affairs. To the contrary, in the Act Congress several times indicated its intention that state law should continue to apply where the Act does not.[11] As we have noted, under Section 6(c) an exchange is authorized to adopt and enforce rules not inconsistent with the Act "and the applicable laws of the State in which it

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[10] In view of the Commission's lack of jurisdiction concerning such matters, its silence when Rule 347 was submitted in 1958 did not constitute "authoritative approval" of Rule 347 (b), as petitioner contends (Pet. Br. 18).

[11] For example, Section 28(a) provides that the rights and remedies provided by the Act are "in addition to any and all other rights and remedies that may exist at law or in equity," and further provides that nothing in the Act "shall affect the jurisdiction of the securities commission * * * of any state * * * insofar as it does not conflict with" the Act or the Commission's rules and regulations thereunder. 15 U.S.C. 78bb(a).

In addition, Section 28(b) provides in pertinent part:

"Nothing in this chapter shall be construed to modify existing law * * * (2) with regard to the binding effect of * * * [exchange] action [to settle disputes between its members] on any person who has agreed to be bound thereby."

The parties (Pet. Br. 15, Res. Br. 16–20) disagree about the proper applicability to the instant case of the "nonwaiver" provision of Section 29(a) of the Act, 15 U.S.C. 78cc(a), which provides:

"Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

If, as we believe, the exchange rule in issue here is not "required" by the Act nor by "any rule or regulation thereunder," Section 29(a) is inapplicable.

is located."[12] There is nothing in the federal regulatory scheme to indicate that the activities of exchanges and their members should not continue generally to conform to applicable state and local law as they were required to do before the Act, where such local standards are not contrary to the express requirements of federal law, the rules or regulations of the Commission, or the regulatory scheme that the Act establishes.

The legislative history and express language of the Act show that a basic intent of the statute was protection of the investing public through the "maintenance of fair and honest markets." See Section 2 of the Act, 15 U.S.C. 78b. Exchange rules that are not substantially related to the statutory objectives should not be considered paramount to otherwise conflicting statutes. Compare *Silver* v. *New York Stock Exchange*, 373 U.S. 341.[13] Rule 347(b), as applied here, cannot be said to be related to the regulatory objectives of the statute in any but the most indirect manner, and there-

[12] Thus, if the law of New York, where the Exchange is located, contained a provision like Section 229 of the California Ann. Labor Code, there would be even less basis for a claim of preemption.

[13] The parties have made frequent reference to *Silver* v. *New York Stock Exchange*, 373 U.S. 341, where this Court considered the question whether the federal Securities Exchange Act of 1934 had impliedly repealed the federal antitrust laws. The preemption issue presented here, however, is governed, not by the principles concerning implied repeal and conflict between different laws adopted by Congress at different times, but by this Court's separate, if analogous, body of authority concerning the sensitive interrelationship between laws adopted by separate, coordinate sovereignties, federal and state. More

fore it is not the type of exchange self-regulation within the scope and purposes of the Securities Exchange Act that might oust conflicting provisions of state law. If the exchange rule in issue before this Court did involve a matter sufficiently important to the Act's objectives to be within the ambit of the Commission's pervasive regulatory oversight as delineated by the Act, state law in conflict with the rule would be preempted. However, the method for resolving disputes about the eligibility of former employees of a member firm to participate in a profit-sharing plan is not such a matter.

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so than with the case of implied repeal, "an unexpressed purpose *to* nullify" state law "is not lightly to be attributed to Congress," *Parker* v. *Brown*, 317 U.S. 341, 351, and a claim of conflict must be, if anything, even more persuasive where state law is concerned than where a claim of implied repeal of another federal law is made. *Penn Dairies, Inc.* v. *Milk Control Comm'n*, 318 U.S. 261, 275. As noted in the Memorandum for the United States as *amicus curiae*, p. 8, n. 6, filed in opposition to the petition in this case, the Commission and the Antitrust Division of the Department of Justice have different positions concerning the applicability of this Court's decision in *Silver* to matters subject to Commission oversight. Both agree, however, that *Silver* generally recognizes the continued applicability of the antitrust and other laws to exchange activities that are not subject to Commission oversight, and both agree that this case does not require the Court to consider further the issues raised in *Silver*.

CONCLUSION

For the foregoing reasons the judgment of the court of appeal should be affirmed.

Respectfully submitted.

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